

**REPORT OF THE AUDITOR-GENERAL TO THE MUNICIPAL COUNCIL AND
KWAZULU-NATAL PROVINCIAL LEGISLATURE ON THE FINANCIAL
STATEMENTS AND PERFORMANCE INFORMATION OF THE NQUTHU
MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Nquthu Municipality which comprise the balance sheet as at 30 June 2007, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 7 to 17.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996, read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The municipality's policy is to prepare financial statements on the entity specific basis of accounting as set out in accounting policy note 1.

Basis for disclaimer of opinion

Inventory

5. Supporting documentation relating to the stock count, stock reconciliations or a detailed ledger account could not be provided for audit. Furthermore the financial statements reflects a nil balance for inventory although it was evident during the audit that inventory was received and issued during the year. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself regarding the existence and valuation of inventory.

Debtors

6. The consumer debtors age analysis could not be provided for audit. As a result I was unable to obtain sufficient appropriate audit evidence to satisfy myself regarding the existence and valuation of the total consumer debtors of R8,5 million.

Income

Sale of electricity

7. As a result of the following, I did not obtain sufficient appropriate audit evidence to satisfy myself regarding the accuracy and completeness of electricity income of R3,2 million:-
 - Transactions in the general ledger are not recorded in date sequence.
 - Service listings, meter readings and service contracts could not be provided.
 - Listings of new connection, reconnections and disconnections could not be provided.
 - Prepaid electricity agreements and prepaid listings could not be provided.
 - The municipality does not have any policy or procedure in place to monitor distribution losses.
 - Reasonable explanations could not be provided to validate fluctuations from actual to budget as well as actual to prior years figures.
 - The municipality experienced software problems which resulted in all new accounts not being opened and ultimately not being billed.
 - For all new applications there were no signed contracts between the municipality and the applicants.

Rates income

8. During the year the municipality has not budgeted or raised assessment rates. There is also no valuation roll and rates policy in place. In these circumstances I was unable to carry out all the audit procedures I considered necessary for audit of rates income.

Other income

9. As a result of the following I was unable to obtain sufficient appropriate audit evidence to satisfy myself regarding the accuracy and completeness of other income and other service charges of R1,2 million:-
 - Invoices for other service charges were not generated.
 - The rental registers, invoices and statements could not be made available. The rental deposits register, agreements or statements were also not available.
 - The registers, invoices or reconciliations for testing of direct income could not be provided for audit.
 - Furthermore the receipts per the general ledger could not be traced back to the actual receipt as they are not captured individually and no reconciliation of the individual receipts were maintained.

Creditors

10. The supporting documents for creditors amounting to R705 000 could not be provided for audit. As a result I was unable to obtain sufficient appropriate evidence to satisfy myself regarding the completeness and the municipality's obligation to settle this balance.

Consumer deposits

11. The consumer deposit register or listings in support of the consumer deposits of R492 000 could not be provided for audit. Consequently, I did not obtain sufficient appropriate evidence to satisfy myself regarding the valuation and completeness of the balance.

Leave Pay

12. The supporting documentation and calculation in support of the leave pay provision of R1,4 million could not be provided for audit. As a result I did not obtain sufficient appropriate evidence to satisfy myself as to the valuation and completeness of the provision.

Investments

13. The balance on a fixed deposit with ABSA bank was recorded as R724 000 in the financial statement. However, the bank confirmation recorded a nil balance. An acceptable explanation for the difference could not be provided. As a result I could not obtain sufficient appropriate evidence to satisfy myself regarding the valuation of the investment.

Value added tax (VAT)

14. As a result of the following, I did not obtain sufficient appropriate audit evidence to satisfy myself regarding the existence, completeness and valuation of the VAT debtor balance of R532 000:-
 - VAT 201 returns were not available for inspection.
 - VAT reconciliations was not performed.
 - VAT returns were not submitted timeously and interest and penalties were not raised in respect of these late submissions.
 - In the absence of the VAT 201 returns, the interest and penalties, which constitutes fruitless and wasteful expenditure could not be quantified.

Fixed Assets

15. As a result of the following, I did not obtain sufficient appropriate audit evidence to satisfy myself regarding the existence, valuation and completeness of the fixed assets totaling R6,7 million:-
 - A fixed assets register was not maintained and a physical stock take of assets was not performed during the year.
 - Listings and supporting documentation for asset additions and disposals could not be provided for audit.
 - Budgeted figures for fixed asset additions were also not available.
16. Furthermore, in the absence of a proper asset register the accuracy of the funding entries and balances recorded under loans redeemed and other capital receipts could not be substantiated.

Employee costs

17. As a result of the following, I did not obtain sufficient appropriate audit evidence to satisfy myself regarding the accuracy and completeness of the salary, wages and allowance expenditure recorded as R367 000 in the financial statements.

- Detailed analytical review procedures could not be performed because a detailed breakdown of the prior year expenses could not be obtained.
- The general ledger for salaries and wages was inadequate as it did not give a breakdown of the components of salaries and wages.
- Included under debtors is a salary suspense account of R15,1 million which was not cleared at year end.
- The IRP5 tax reconciliations were not performed..
- Employees tax is being incorrectly calculated on employees salaries.
- A reconciliation of the the salaries and wage expense to the VIP system could not be performed.

Provision for doubtful debts

18. As disclosed in accounting policy note 6.6 to the financial statements the current provision for doubtful debts is not adequate. However in the absence of the debtors age analysis, I was unable to carry out alternative audit procedures to reasonably quantify the underprovision.

Expenditure

19. Payment vouchers in support of general expenditure of R1 880 500 and expenditure on repairs and maintenance of R64 343 could not be provided for audit. Consequently, I did not obtain sufficient appropriate evidence to satisfy myself regarding the validity and accuracy of the total expenditure of R13,7 million

Statutory funds

20. In terms of section 103(b)(i) of the Local Authorities Ordinance, 1974 (No. 25 of 1974), the council shall pay into each Capital Development Fund (CDF) not less than 3% of the annual revenue accruing to the rate and general service and to the relevant trading fund. During the year no contribution was made to the fund and there is no evidence that exemption was obtained from the Minister of Local Government. As a result the capital development Fund is understated and accumulated surplus is overstated by R800 000.

Interest income

21. Interest income has not been accounted for in the financial statements. As a result income is understated by R402 000, investments are understated by R197 000 and the cash at bank is understated by R205 000.

Conditional Grants

22. Completeness of grant income could not be tested as individual grants could not be identified and verified. Grants appeared on the bank statements with no identification or descriptions. No supporting documentation was made available for all grants to confirm existence, valuation and completeness.

Furthermore six reserves have been overspent by a total of R13,9 million. Unidentified grants of R11,1 million were disclosed, details of which were not available.

23. The terms and conditions of the grant could not be ascertained as the grant could not be identified. Expenditure could therefore not be verified as to whether it had been spent in accordance with the applicable terms and conditions of the grant.

Capital commitments

24. As a result of the following, I did not obtain sufficient appropriate audit evidence to satisfy myself regarding the accuracy and completeness of the disclosure of capital commitments:

- There is no contract register for capital commitments
- No proper controls to manage the expenditure on contracts

Related party transactions

25. Related party transactions to the value of R215 000 were not disclosed in the financial statements. These transactions relate to payments for the supply of diaries, calendars and t-shirts made to a firm owned by the fiancée of the chief financial officer.

Comparative figures

26. Opening balances in the general ledger do not agree to the prior years audited financial statements due to adjustments that were subsequently processed as a result of the prior year audit. However comparative figures in the financial statements were not adjusted.

27. Furthermore the issues included in this report were also reported in the previous year. As a consequence the affected comparative amounts and opening balances are also either misstated or could not be verified.

Disclaimer of opinion

28. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Nquthu Municipality. Accordingly, I do not express an opinion on the financial statements. [!\[\]\(8bba887393ca45b761e5cb49e755e762_img.jpg\) E.1.5](#)

Emphasis of matter

I draw attention to the following matter:

Going concern

29. The 2006/07 financial statements does not draw attention to doubts concerning the municipality's ability to discharge all its obligations in the normal course of business, in the foreseeable future. The doubts arise in view of the following:

- The operations of the municipality are currently funded by long and short term finance.
- A salary suspense account of R15 million had not been cleared at year end. If this balance is cleared it would result in the municipality incurring an overall accumulated deficit.
- The provision for doubtful debts has not been fully provided.
- Fund and reserve balances are not adequately supported by cash funds.
- Repayments on the new DBSA loan has placed strain on the finances of the municipality.
- Overspending on conditional grants has not been accounted for under expenditure.

- Payments for goods and services are not made within 30 days of receipt of invoices as required by section 65(2)(e) of the MFMA.
- Due to the cash flow problems experienced, the municipality has entered into arrangements with its creditors.
- These conditions indicate the existence of an uncertainty which casts doubt on the municipality's ability to continue as a going concern.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

Non-compliance with applicable legislation

Municipal Finance Management Act (MFMA)

30. The credit limit for the bank overdraft and the terms of the agreement for the overdraft facility were not approved by council as required by section 45(3)(b) of the MFMA. Furthermore the municipality did not inform National Treasury of the overdraft facility as required by section 70(2) of the MFMA.
31. During the year under review the municipality did not develop and implement a risk management policy and fraud prevention plan. The municipality has therefore not effectively managed its risks in accordance with section 62(1)(c) of the MFMA.
32. An audit committee as required by section 166 of the MFMA did not exist during the year under review.

Basic Conditions of Employment Act, 2002 (Act No.11 of 2002)

33. It was noted that employees had worked excessive overtime which in some instances were above 30% of their basic income in contravention with section 10 of the Basic Conditions of Employment Act, 2002.

Income Tax Act, 1993 (Act No. 113 of 1993)

34. It was noted that most of senior management occupy municipal houses and no PAYE is being deducted on this fringe benefit. This is in contravention with the Income Tax Act.

Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

35. All councilors did not declare their financial interest in writing to the municipal manager, as required by section 7(1) of schedule 1 of the MSA.
36. The performance contract of the municipal manager did not include specific measureable performance objectives aligned to the IDP and Service Delivery Budget Implementation Plan as required by section 57(4) of the MSA.

Matters of governance

Internal audit

37. A review of internal audit revealed the following weaknesses which indicates that the internal audit unit was not effective in fulfilling their responsibilities in terms of the internal audit charter and section 165(2) of the MFMA:

- There were no risk based audit plans, internal audit charter, 3 year rolling plans, annual audit plan and internal audit program for the financial year.
- The staff lacked management support and direction.
- There were no clear lines of reporting for the internal audit staff.
- Internal audit work was only performed in June 2007 although staff were employed since July 2006.

38. Furthermore, it was noted that internal audits was not planned and performed in accordance with applicable standards, that is:

- The purpose and the scope of the audit were not documented.
- No management responses were documented.

Value for Money

Human resource management

39. Three key management posts were still vacant. These were the Director of Development Planning and Housing, Director of Corporate Services and the Director of Finance

Infrastructure Projects

- 40. Tender contracts to the value of R6,4 million were awarded for 4 infrastructure projects to contractors that had a lower Certificate of Industrial Development Board grading than the minimum required.
- 41. Two contractors were not paid within the stipulated 30 days as per section 65(2)(e) of the MFMA.
- 42. Two infrastructure projects although completed, were not being fully/optimally utilized.

Supply chain management

- 43. List of accredited suppliers of goods and services as required by regulation 14 of the supply chain management regulations was not compiled.
- 44. The audit revealed that an adequate needs analysis or feasibility study was not performed for the construction of a crèche.
- 45. There were also no adequate needs determination and feasibility study performed for goods and services required, and for which tenders had been invited.
- 46. The municipal manager did not submit a report to the mayor on the implementation of the SCM policy in terms of Regulation 6(3) of the Supply Chain Management Policy.

Internal Control

- 47. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assess ment of risks	Control activities	Information and commu- nication	Monitoring
Basis for disclaimer					
Inventory	✓		✓	✓	✓
Debtors	✓		✓	✓	✓
Sale of electricity	✓		✓	✓	✓
Rates income	✓		✓	✓	✓
Other income	✓		✓	✓	✓
Creditors	✓		✓	✓	✓
Consumer deposits	✓		✓	✓	✓
Leave pay	✓		✓	✓	✓
Investments	✓		✓	✓	✓
Value added tax	✓		✓	✓	✓
Fixed assets	✓		✓	✓	✓
Employee costs	✓		✓	✓	✓
Provision for doubtful debts	✓		✓	✓	✓
Expenditure	✓		✓	✓	✓
Statutory funds	✓		✓	✓	✓
Interest income	✓		✓	✓	✓
Conditional grants	✓		✓	✓	✓
Capital commitments	✓		✓	✓	✓
Related party transactions	✓		✓	✓	✓
Comparative figures	✓		✓	✓	✓
Emphasis of matter					
Going concern	✓		✓	✓	✓
Other matters					
Non-compliance with applicable legislation	✓	✓	✓	✓	✓
Matters of governance	✓	✓	✓	✓	✓
Value for money	✓		✓	✓	✓

Unaudited supplementary schedules

48. The supplementary information set out on pages 18 to 23 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion on them.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

49. I was engaged to audit the performance information.

Responsibility of the accounting officer

50. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

51. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) read with *General Notice 646 of 25 May 2007* and section 45 of the MSA.

52. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

53. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings

Non-compliance with regulatory requirements

54. During the year under review the municipality did not have a performance management system in place as required by section 38 of the MSA.

55. Furthermore, the municipality did not prepare a performance report reflecting the performance of the municipality and of each external service provider as required in terms of section 46 of the MSA.

APPRECIATION

56. The assistance rendered by the staff of the Nquthu Municipality during the audit is sincerely appreciated.

Pietermaritzburg

30 November 2007



A U D I T O R - G E N E R A L